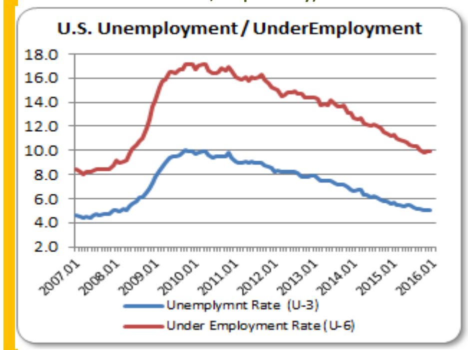
Phoenix Investment Management, LLC

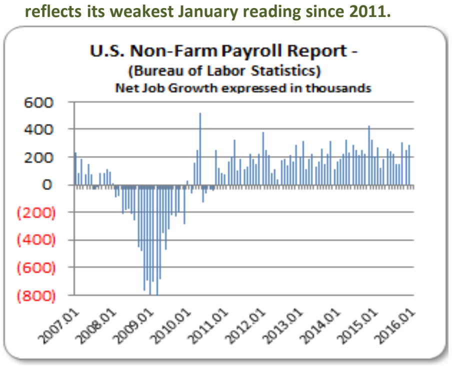
Monthly Macro Commentary

- February 2016 -

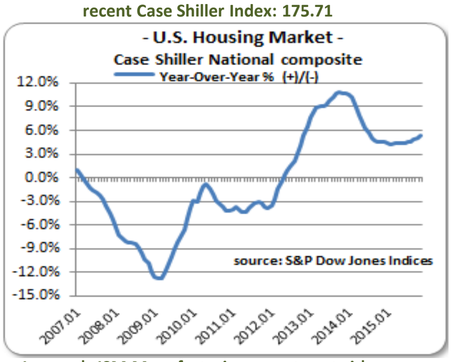
In January, both the UnEmployment & Under-Employment numbers continue to suggest strength in the labor markets (4.9% and 9.9%, respectively)



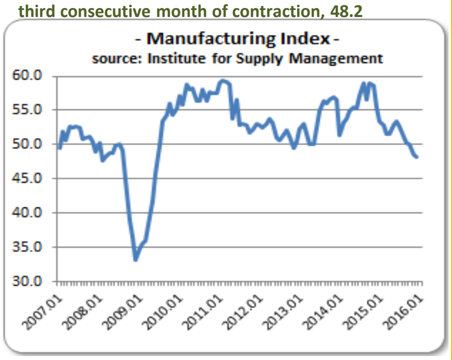
On the flip-side, last month's Jobs report (+151,000) reflects its weakest January reading since 2011.



Housing market continues to show signs of further strengthening, as evidenced by the most recent Case Shiller Index: 175.71



January's ISM Manufacturing report posts it's third consecutive month of contraction, 48.2



Report Contents

- **Equity Market Overview**

  Up until recently, U.S. Equity markets have been in a sharp correction. Inside, I provide analysis as to what many are pointing to as drivers behind the selling pressure as well as my own views in terms of where the markets may be heading.

- **The U.S. Dollar**

  The Dollar has appreciated considerably over the past few years. It's important to understand the pluses and minuses a "Strong" Dollar's impact poses to the U.S. economy, its major trading partners throughout the Globe, as well as how it might impact your portfolio.

- **The Federal Reserve**

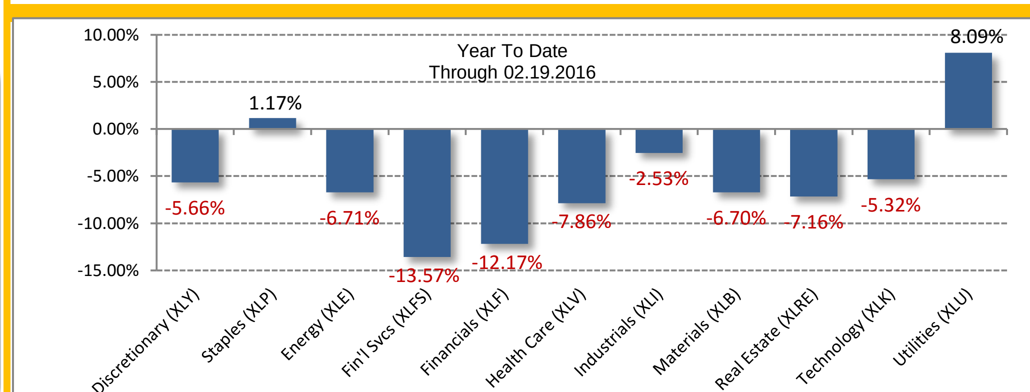
  The Fed moves away from ZIRP, commonly referred to as Zero Interest Rate Policy.
  At present, the change is having a fairly significant impact on both Corporate and Investor psyche.

- **The Collapse in Crude Oil**

  Lower Gasoline prices have had a positive impact on Household discretionary income over the past year and a half.
  Understanding the longer term effect, however, is critical.

U.S. Sector Overview

Source: State Global Advisors



Additional Major Macro Indicators of Note

Year	U.S. Federal Debt[1]	Status	Trend / Key	#
2009	$11.9 Trillion	Although pace of Debt has slowed; partisan divide offers little hope & poses significant challenges well into the future.	Some Improvement	1
2010	$13.5 Trillion			2
2011	$14.8 Trillion		3.5	3
2012	$16.1 Trillion			4
2013	$16.7 Trillion			5
2014	$17.8 Trillion			6
2015	$18.1 Trillion			7

Year	U.S. Federal Deficit[2]	Status	Trend / Key	#
2009	($1,412,688)	Annual Deficits have much improved since the height of the Financial crisis.	Improving	1
2010	($1,294,373)			2
2011	($1,299,593)		2.5	3
2012	($1,086,963)			4
2013	($679,544)			5
2014	($484,602)			6
2015	($438,899)			7

Year	U.S. Net Job Creation	Payroll Cuts - Mass Layoffs	Trend / Key	#
2009	(5,070,000)	1,288,030	Significant Improvement	1
2010	1,066,000	529,973		2
2011	2,087,000	606,082	2.0	3
2012	2,149,000	523,362		4
2013	2,311,000	509,051		5
2014	3,015,000	483,171		6
2015	2,735,000	598,510		7

Year	U.S. Unemployment Rate (U-3)	Status	Trend / Key	#
2009	9.9%	Although much improved, true scope of Unemployment is difficult to quantify given Labor Participation Rate.	Improving, but Murky	1
2010	9.4%			2
2011	8.5%		3.5	3
2012	7.9%			4
2013	6.7%			5
2014	5.6%			6
2015	5.0%			7

Year	Total Public Construction Spending	Total Private Construction Spending	Trend / Key	#
2009	314,895	591,648	Significant Improvement	1
2010	303,966	505,290		2
2011	286,407	501,925	2.0	3
2012	279,311	571,145		4
2013	270,682	635,669		5
2014	275,698	717,711		6
2015	291,204	806,142		7

Year	U.S. Labor Participation Rate	Status	Trend / Key	#
2009	64.6	Official Data suggests very little improvement since the height of the Financial crisis, making it incredibly difficult to gauge true state of Labor.	Horrendous Conditions	1
2010	64.3			2
2011	64.0		7.0	3
2012	63.7			4
2013	62.9			5
2014	62.7			6
2015	62.6			7

Year	U.S. Auto Sales	Status	Trend / Key	#
2009	10,402,000	Auto sales in 2015 established all-time highs in sales.	U.S. record in 2015	1
2010	11,555,000			2
2011	12,735,000		1.0	3
2012	14,443,000			4
2013	15,532,000			5
2014	16,435,000			6
2015	17,386,000			7

Year	New Residential Sales - (Single Family)	Status	Trend / Key	#
2009	374,000	Although clearly not back to pre-recession highs, the strength of Housing, along with Auto sector, continues to help boost the economy.	Significant Improvement	1
2010	322,000			2
2011	305,000		2.5	3
2012	369,000			4
2013	429,000			5
2014	439,000			6
2015	499,000			7

Source Legend Key

1 U.S. Treasury
2 Congressional Budget Office
3 Bureau of Economic Analysis
4 U.S. Dept. of Labor, Bureau of Labor Statistics
5 Challenger, Gray & Christmas
6 U.S. Census Bureau

Trend Legend Key	
1	Established / ing new highs
2	Significant Improvement
3	Some Improvement
4	Weak OR Difficult to Assess
5	Showing signs of Deterioration
6	Significant Deterioration
7	Horrendous Conditions

Saturday morning, February 27th, 2016

I had wanted to wait until the end of the first quarter before publishing this commentary, but given that February is essentially over (hard to believe); the overall state of our markets, global geo-political conditions, and by extension, investor psyche, prompted me to publish over this weekend. People are a bit nervous, I sense concern.

My biggest concern at this point lies in the continuing brinkmanship involving Oil. Given its obvious importance within the global community, if production remains at or near existing levels, the likelihood that we'll see normalization of prices within the energy sector is remote, at best.

If that were that to happen, I feel very strongly that the negative impact to the national, as well as local economies, will accelerate. Job losses could very well accelerate. Growth will decelerate. Business investing will decelerate; all of which could very well tip the scales and bring us into recession.

You've not heard me mention this distinct possibility in over six years.

That's a **worst case scenario** and hopefully illustrates how impactful I think it could be. Remember, paying less at the pump is nice, but a 50% drop in gasoline prices is not a good thing, longer term. Thankfully, just as with the Fiscal Cliff scenario here in the U.S. a few years back, I DO think that calmer heads will prevail, ego's will be set aside, at least temporarily, and a general consensus will be reached.

Until then, the commodity will more than likely be range bound, and volatility will continue. Additional Guidance from Chair Yellen & the Federal Reserve heading into the 2nd quarter will be critical to watch for, without a doubt. Below is my guidance heading into March.

I. MARKET PERSPECTIVE & ANALYSIS:

Last year was incredibly challenging for our Equity markets, no doubt. To better illustrate, I remember reading an article on CNBC back on December 31st, in which it talked about **2015** being "**The Hardest Year To Make Money in 78 Years**."

Think about that. Last year was one in which all three major equity indexes posted negative returns for the year (ex-dividends). So to characterize it as a difficult year is clearly an understatement.

Up until recently, 2016 really has been no different. Equity markets have been selling off globally. Domestically, there's increased talk of Recession. In Europe, although officially out of recession; its overall growth is both very fluid & tepid. Events in China, (more specifically, its slowdown & currency), continue to have destabilizing effects around the globe.

So with our Equity markets picking up right where they left off, and the DJIA establishing its **worst start ever**, shedding 1,658.29 points (roughly 9.5%); all during the first twelve trading days; people are nervous, and comparing current events to 2008-2009.

And yet, despite the selling pressure and overall pessimism, this is **not** 2008-2009.

Let's briefly look back to 2015. Equity markets here were negative for the year, yes, but according to Societe Generale, if we were to include dividends; equities were actually the BEST-performing asset class of 2015. Better than the traditionally "safer" **long-term bonds. Better than short-term Treasury bills**. And in case you're wondering, Commodities, given the collapse in crude oil and basic materials, were by far the worst.

Societe Generale's Larry McDonald, head of U.S. macro strategy, believes the "lag in performance is one reason major money managers have done so badly this year, calling it an "absolute meat grinder of a year."

"Hall-of-fame legends, **Warren Buffett, David Einhorn, Carlos Slim .. all had bad years."**

So yes, incredibly challenging.

So one of the primary questions to ask is **why**?

1. The markets had had a respectable 2014, posting fairly modest returns.
2. The economy was said to be on fairly firm footing, with consistent, albeit modest, **GDP growth**, in the **2.4%** range.
3. The labor market, in 2014, saw an increase in non-farm payrolls of over **3 million**, the **first time** in **17 years**.

Cumulatively, that's hardly a lead-in for the kind of year equities just suffered. **So what happened**?

To better answer that question, I've laid out the following major drivers (in no particular order) which many of us point to for the current volatility, instability, and subsequent sell-off.

I. U.S. Dollar
II. Federal Reserve Monetary Policy
III. Collapse in Oil

Let's take a closer look at all three.

I.The Strong Dollar

Our Dollar has been strong; and gaining momentum, particularly over the past 4-5 years. One question I'm asked fairly often is with regards to the Dollar, and whether **a strong Dollar is good or bad?**

On the surface, it might seem fairly obvious, right? Why wouldn't one want a strong Dollar?

Let's start with the basics. When we talk about the strength of the Dollar, what we're essentially comparing is **its** strength relative to **another** currency. When the $ Dollar appreciates vs. another, outside of the other depreciating (see below), a number of things happen.

Euro - € depreciation vs. Dollar - $

So, as a quick for instance, let's say our dollar is appreciating relative to, say, France's currency (the Euro). If you were to visit while on vacation, you'd receive more for our dollar when converting to the local currency, the Euro, an obvious bonus.

On the other hand, though, and **this is incredibly important,** there's always a flip side, and that is this: a strong dollar also generally means that **our** exported products become **more** expensive overseas, which means that a price-conscious person in France might think twice about buying an imported U.S. product, especially if a comparable French product can be purchased for less.

Additionally, with its currency weaker relative to ours, their imports into the U.S., are more than likely now less expensive than our comparable products sold here, making it easier for us to afford that fancy imported widget we've always wanted from overseas, for example; another obvious bonus. That's **a bonus for the consumer** but a negative for U.S. businesses and their products & services.

So in this case, the Dollar's excessive strength makes our product **less competitive**, which, among other things, can hurt profits, which in turn hurts corporate earnings, which ultimately hurts stocks.

And when investors see a drop in earnings, they tend to sell; and when enough sell, it creates downward pressure on stocks, which, in turn, hurts markets.

This is exactly what's been playing out for some time now. It shows why, **if** both excessive **and** long-term, a strong Dollar can have a negative impact on markets.

II. COLLAPSE IN CRUDE OIL

Although the drop in oil prices wasn't entirely unexpected, the velocity and scope was. Part of the drop in prices can be linked to the strong Dollar I just spoke to, but there ***were*** other factors, for sure.

As a backdrop, West Texas Intermediate (WTI, essentially our crude) was trading for roughly $107 barrel two summers ago (July 2014). It's now trading at roughly $30, or, a **72% multi-year drop** in prices; this, for arguably the world's most important commodity. Just an amazing drop. So much so that it caught everyone off guard; including me.

Tracking the commodity, when I saw that crude had sold-off by roughly 35% (late Fall/early winter 2014), I began adding positions across the board (many of you, for ex., hold Haliburton, Noble Energy, Conoco Philips, and certain energy sector ETF's). I did so as I believed then (as I do now, even more so), that the energy sector had been incredibly oversold and by extension, mispriced; making it that much more attractive from a valuation, or price, standpoint.

Remember, a big part of my thesis has always been to find **bargains with sound fundamental value**. It's hard to argue that Oil doesn't meet those criteria.

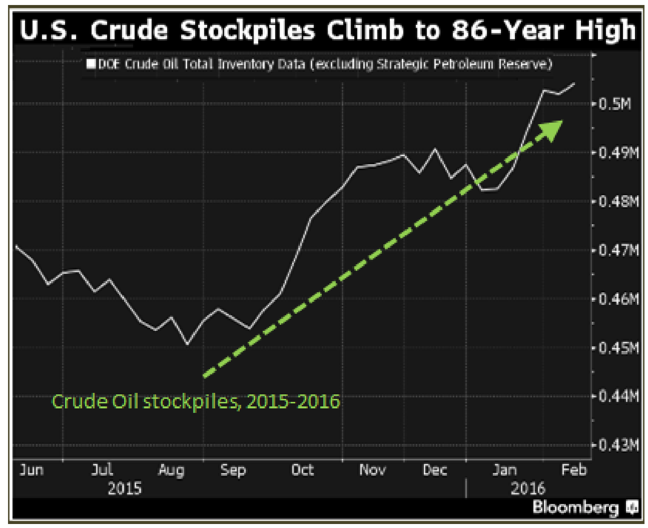
And as the sell-off accelerated, I continued adding to positions well into last month as WTI eventually broke **$27/barrel** (representing a 75% decline).

That being said, despite Friday's selling, I feel very strongly that oil is at or near bottom. It's not customary for a PM to go on record, but in my opinion, when one weighs all of the factors, I just don't feel the sell-off is justified. That's not to say that the volatility won't go away, or that we'll see $107 per barrel overnight. That will not happen. No.

But one of the globes primary commodities has now retraced 75% off multi-year highs. By **75%.** A correction of that magnitude I would characterize as a classic example of a mispriced market; accentuated by panic-selling, which again, makes it that much more attractive on multiple levels.

So the question again, **why**? **What happened** to cause arguably the World's most important commodity to lose three-fourths of its value in just 18 months? Aside from the Dollar, it's really a classic example of Supply & Demand.

Over the past decade or so, energy companies have been able to extract fossil fuels more affordably, most notably, through a process called Hydraulic Fracturing, or Fracking. The common misconception is that it's a new technology, when, in fact, the process has been around for roughly 150 years. The reason for its more widespread use involves a change in the overall technique. This, in turn, has enticed new players into the marketplace which, in turn, created an enormous **glut of supply**, which in turn, has caused the commodity price to essentially crater.



On one end, this is good. Here, excess supply can, and oftentimes does, have a nice effect on consumers. We can head to the pump & fill our tanks for a fraction of what it cost us not too long ago.

Theoretically, this frees up discretionary income, which means we have more money available for expenses. We also can put a little bit more in savings, OR, we can spend. And when consumers spend, that tends to have a positive effect on economic growth.

On the other hand, if this goes on for too long and/or the drop in prices is excessive, it can actually have a negative impact on the economy. **How?**

Well, as a for instance, energy producing states like Texas, will and have, suffered as a result of the collapse in Oil prices. **Why?**

Think about it. If your state's major source of revenue has been overly commoditized in a saturated market, prices fall. When prices fall, businesses suffer. When businesses suffer, some form of cost-cutting is typically engaged, typically in the form a **reduction in Cap-Ex spending**, or, **jobs**. And of course, when job lay-offs increase, the local (and potentially, national) economy will suffer.

Taking it a step further, and on a more global scale; since we're now on firmer footing in terms of energy production when compared to traditionally energy-producing countries like Russia, Venezuela, and of course, **OPEC**, we've infringed on an area historically dominated by a small cartel. And when you do that, you can, and probably should, expect some pushback.

And it's exactly that pushback that's been manifested in the form of increased production. So instead of slowing production, the opposite has happened; with major producers, pardon the expression, hitting the gas pedal. Pursuing that course of action allows them to protect their turf, so to speak. **How?**

The common interpretation is that by increasing production, smaller producers here in the U.S. will suffer. **Why?**

Well, if OPEC has a cost of roughly $10 per barrel, for example, while our cost is roughly $50; with Oil trading at roughly $30, those numbers don't bear out for everyone.

So if I'm a small U.S. producer, and I'm paying $50 while receiving $30, at some point I'm either going to increase debt (thereby hurting my balance sheet), engage in lay-offs, **OR**, eventually be forced to cease operations altogether. And if enough players exit the market, the theory is that production will drop, prices will stabilize, and eventually, rise.

Until that happens, absent some other form of intervention, I expect this volatility in crude to continue well into the year. Exactly **when** that happens is the question. And it's that lingering question that has had the Oil sector in sell-off mode, which in turn, has impacted markets across the globe.

III. FEDERAL RESERVE MONETARY POLICY

Lastly, our Federal Reserve. In December, our central bank, the Fed as it's commonly referred to, increased interest rates for the first time in nearly a decade (June of '06 to be exact).

More specifically, the Fed increased what's called the Federal Funds Target Rate through the use of the Discount Rate, which represent overnight rates available to banks within the banking system.

In Layman's terms:

The Fed has what's called a **dual mandate**, that dual mandate requires that it seek two things:

1. Full Employment
2. Price Stability.

So how does it do this? And can it increase employment and overheat the economy at the same time?

The short answer is yes. If the economy does overheat, then we're typically referring to I**nflation**. And if the economy has slowed down too much; then we're generally referring to **Deflation**. (Granted, I'm being a bit simplistic, but these are topics that I can only get into in greater detail in a separate commentary).

So our Fed, in order to meet its mandate, will look to maintain that delicate balance through something called **Open market Operations**.

Ok, so what exactly does this mean? Well, if the economy is struggling, one of the things the Fed will do is lower what's called the Discount Rate. When it lowers the rate, it makes it cheaper for banks to borrow. When it's cheaper for banks, theoretically, they're encouraged to lend, which, in turn, stimulates the economy.

For perspective, during the **'07-'09 Recession**:

- The economy was in crisis.
- Banks were failing.
- Lending froze up.
- Millions of jobs were lost.
- And partly as a result, millions of Americans were left without homes.

That sort of crisis environment calls for the President and Congress to pursue what's called **Expansionary Fiscal policy** (increase spending, for example, a course our last two presidents, and three Congresses have pursued).

While that's happening, the Fed may look to keep interest rates low in order to stimulate the economy, which is referred to as **Expansionary Monetary Policy**. In a nutshell, if we had the choice: do we prefer a loan at 2% or 5%? The answer is obvious.

Since we're no longer in an environment in which banks failures are a leading news story, and we're no longer losing millions of jobs, and the housing crisis has ended, **we're no longer in crisis mode**.

Although we haven't fully recovered from this massive global crisis, the progress we've made is significant. And because we're no longer in crisis mode, the argument is that there's no need to keep interest rates at or near zero. So the goal is to try to begin to normalize rates as much as possible.

So that's the backdrop. Here's the problem:

The fear is that should the Fed raise interest rates too aggressively, it could very well impact what some consider a still relatively fragile economy by stunting the consumer. The scenario is that if you stunt the consumer, you run the risk of stunting their spending. If you do that, and consumers do in fact spend less, then you run the risk of stunting corporate earnings. If you stunt corporate earnings; you run the risk of stunting overall economic growth. And THAT fear & uncertainty is part of what has so many concerned.

Now, even though the Fed has said that it's going to be "data dependent" (meaning that it'll act in response to what the overall macro environment is suggesting, both here as well as overseas), for many investors, that's not enough. And so I'm finding that a fair amount of investors have largely been anticipating & selling, which has greatly contributed to the substantial drop we've seen in the markets these past several months.

So those are what many consider to be the **three primary drivers** behind both a **difficult 2015** as well as a **very difficult start to 2016**.

What many people are ignoring is this:

IF the Fed **is** raising rates, the takeaway really HAS to be that we're on much firmer footing. In other words, there's no reason to maintain crisis mode rates. That's not insignificant.

Why keep a patient in the ICU if they're walking the halls on their own?

The U.S. economy is on firm footing, especially when compared to the rest of the globe. The problem, again, though, lies in the fact that some are largely ignoring this fact and are "Selling on the News."

Unless you're day-trading, or have a very short investment time frame, tune the sensationalist headlines out to the best of your ability. I'm not suggesting you ignore it; just the opposite, actually. I've **always** treated sell-offs with a high degree of respect, balanced with a certain amount of potential opportunity.

More specifically, it's my view that longer term investors should be capitalizing on the recent drop in markets, pursuing a value-oriented approach.

That is the course that I've been following, and will continue to do so, unless there is an obvious change in overall macro-economic conditions.

Oil - Historical Perspective

Crude actually experienced **a very similar decline** during this past recession (December '07 – June '09).

As late as July 3rd, 2008, WTI was trading just over $145/barrel. Only five months later, it hovered just over $30, or a massive 79% drop.

So this commodity correction, as ugly as it may look, is certainly not unique. To better illustrate, I've attached a graph from the Federal Reserve.

Hopefully, it underscores the similarities between the two.

Oil is cheap; but it's cheap for a reason. Too much supply and not enough demand to propel the price higher.

That being said, I'm being very selective in terms of what I'm investing in, particularly in the Oil space.

For those thinking about Oil as an investment, I highly recommend that they do the same.

In the interim, call me with any questions on the markets or your portfolio. 2015 was difficult, without a doubt.

Maintaining focus, discipline, and applying a tactical/opportunistic mindset during extreme periods of volatility are, in my opinion, critical heading into the spring. In that respect, I'll continue to do my best.

As always, thank you again for your trust and confidence.

Best,

\- Joe

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Investing involves risk, including the risk of loss of principal.
Before investing, consider your own individual Risk Tolerance, Time Horizon and individual Investment Objectives

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*The **Dow Jones Industrial Average** (DJIA) is a price-weighted average of 30 large publicly traded corporations (primarily industrials) commonly referred to as blue-chip stocks. The Dow, as it's frequently referred to, is considered a barometer of overall U.S. economic health. The components which make up the index are subject to general declines, market, corporate, geo-political risk, to name a few.*

*The **S&P 500 Index (S&P 500)** is an unmanaged index of 500 large publicly traded companies. The index is a market value weighted index, meaning that each stock's weight is proportionate to its market value. The companies comprising the index are chosen for market size, liquidity and industry grouping, among other factors and is designed to be a leading indicator of U.S. equities, a proxy for overall U.S. economic health, and generally meant to reflect the risk/return characteristics of publicly traded companies with large market capitalizations. The index components and their weightings are determined by **S&P** Dow Jones Indices.*

The indices are presented to provide you with a basic understanding of their historic long-term performance and are not presented to illustrate the performance of any security. Investors cannot directly purchase any index.

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